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October 3, 2008

VIA ECFS

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th St., SW
Washington, D.C. 20554

Re: *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92

Dear Ms. Dortch:

Recently, renewed attention has been directed to the question of whether bill-and-keep is an appropriate approach to intercarrier compensation reform. On September 24, 2008, Qwest Corporation ("Qwest") filed an ex parte letter urging the Commission to adopt bill and keep as the "ideal solution for comprehensive ICC reform."[1] We have been asked to respond to Qwest submission on behalf of Cavalier Telephone, Nuvox, and XO Communications.

In Qwest's view, a bill-and-keep approach to intercarrier compensation, rather than a system where carriers pay regulated rates to each other for transport and termination, is "the only solution that is a comprehensive fix of all of the broad variety of arbitrage problems … that underlie the current ICC regime."[2] The Commission should reject Qwest's suggestion for the reasons explained below. Before the Commission even considers Qwest's appeal, however, it should ensure that its record on bill-and-keep is up-to-date and that all interested parties have

1 Letter from Melissa E. Newman, Vice President, Qwest, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket No. 01-92, WC Docket No. 05-337, CC Docket No. 96-45, CC Docket No. 99-68, WC Docket No. 07-135 and WC Docket No. 04-36 (filed Sept. 24, 2008) ("*Qwest Sept. 24th Ex Parte*"), at 2.

2 *Id.*, at 8.

been afforded the opportunity to express their views by providing an additional round of comment on this issue.

I. THE RECORD REGARDING BILL-AND-KEEP IS STALE

Qwest's submission attempts to reverse prior Commission orders rejecting mandatory bill-and-keep, and revive a debate that has been dormant at the Commission for several years. In 2000, an OPP Working Paper by Patrick DeGraba proposed a unified approach to interconnection pricing called Central Office Bill and Keep.[3] That proposal generated considerable discussion and disagreement that carried through to the Commission's 2005 *Further Notice of Proposed Rulemaking* ("*FNPRM*") in this docket.[4] Since that time, however, various comprehensive intercarrier compensation proposals, all of which include ongoing charges for traffic termination, – including the Missoula Plan[5] and, more recently, the Verizon plan[6] – have been offered and debated extensively on the record. At the same time, there has been virtually no discussion or advocacy regarding mandatory bill-and-keep and the record regarding bill-and-keep has become hopelessly stale. For that reason, the Commission should not even consider adopting a mandatory bill-and-keep scheme without first seeking additional input from interested parties through a new round of comments. Further, because the adoption of a mandatory bill-and-keep regime would represent a radical departure from the alternatives that have been under active consideration at the Commission for the past several years, the Commission must provide an additional opportunity to comment on the approach in order to ensure that interested parties' due process rights are protected.

II. THE COMMISSION CANNOT LAWFULLY COMPEL INDUSTRY-WIDE BILL AND KEEP ARRANGEMENTS

As is demonstrated hereinafter, the adoption of mandatory bill-and-keep arrangements is extremely ill advised as a policy matter. Apart from the theoretical merits of a bill-and-keep system, however, it is critical to understand that the Commission simply lacks legal

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3 DeGraba, Patrick, *Bill-and-Keep at a Central Office as the Efficient Interconnection Regime*, OPP Working Paper No. 33 (Dec. 2000) ("*DeGraba Paper*"), at ¶ 4

4 *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Further Notice of Proposed Rulemaking*, FCC 05-33 (rel. Mar. 3, 2005) ("*Intercarrier FNPRM*").

5 *Ex parte* letter from the NARUC Task Force on Intercarrier Compensation to FCC Chairman Kevin J. Martin, CC Docket No. 01-92 (Jul. 24, 2006), including attachments containing the Missoula Plan, the Executive Summary of the Missoula Plan, and a Legal and Policy Overview of the Missoula Plan.

6 Letter from Susanne A. Guyer, Senior Vice President, Verizon, to Chairman Kevin Martin, Federal Communications Commission, CC Docket No. 01-92, CC Docket No. 96-45 (filed Sept. 12, 2008).

authority to require all local exchange carriers ("LECs") to exchange traffic on a bill and keep basis. Congress was clear in adopting Section 251(b)(5) the 1996 Act that the touchstone for establishing rates for interconnection is "cost", and that all LECs are entitled to charge rates that recover their just and reasonable costs of providing interconnection services. The specific rate to be charged is not specified, but it is eminently clear that "free" is not a result that the Commission can impose.

The legal roadmap for establishing pricing for interconnection services provided pursuant to Section 251(b)(5) is found in Section 252(d). Congress specified therein that pricing for reciprocal compensation is "just and reasonable" only when the rates allow for the "mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." [7] Clearly, LECs have a statutory right to recover the costs incurred in terminating traffic for other carriers. Critically, it is equally clear under the statute that LECs have a right to recover those costs by charging the carrier that delivers traffic for termination. "Mutual" means "common to both parties...each acting in return or correspondence to the other...", and "reciprocal" is defined as "directed by each other toward the others...."[8] Accordingly, the statute is express that LECs are to recover the cost of terminating traffic by charging each other, and not by shifting the burden to third parties, such as by increases in end user subscriber line charges ("SLCs") or through some new governmental universal service mechanism such as the Recovery Mechanism ("RM") proposed by Verizon. The Commission is thus statutorily barred from requiring all LECs to implement bill and keep arrangements.

Of course, the Act does not preclude individual LECs from voluntarily negotiating agreements that incorporate bill and keep arrangements. Sec. 252(d)(2)(B)(i) permits LECs to "waive" their rights to mutual recovery when they determine that there is an "offsetting of reciprocal obligations." In other words, when LECs determine that the exchange of traffic is in balance, they can voluntarily agree between themselves to exchange traffic on a bill-and-keep basis. But the notion of waiver necessarily means a knowing and voluntary relinquishment of rights. Regulators cannot make that judgment for them; certainly at least not without examining whether the exchange of traffic between two discrete carriers are highly likely to be in balance. Neither the FCC or state commissions can make an industry-wide assessment of whether traffic is likely to be in balance, and cannot compel LECs to waive their rights to reciprocal compensation that recovers the "additional costs of terminating such calls."[9]

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7 47 U.S.C. § 252(d)(2)(A)(i)

8 Black's Law Dictionary, 7th Ed. Pp. 707, 1276.

9 47 U.S.C. § 252(d)(2)(A)(ii)

Importantly, the Commission already has determined that bill and keep arrangements do not provide for recovery of costs as required by the Act. In its seminal *Local Competition Order*, the Commission examined this issue and found that "carriers incur costs in terminating traffic that are not de minimis and, consequently, bill and keep arrangements that lack any provisions for compensation do not provide for recovery of costs."[10] The Commission went on to observe that "as long as the cost of terminating traffic is positive, bill and keep arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic," and observed that when traffic is in fact likely to be in balance, it is reasonable to believe that LECs would exercise their statutory right to enter into bill-and-keep arrangements voluntarily.[11] The Commission did not bar state commissions from imposing bill and keep arrangements in discrete situations, but made clear that states could require bill-and-keep only where they determined after investigation of particular carriers that the "traffic is roughly balanced in the two directions and neither carrier has rebutted the presumption of symmetrical rates."[12]

Thus, apart from the policy shortfalls of Qwest's proposal, it is clear that the Commission cannot implement it without first seeking statutory changes from Congress.

III. MANDATING BILL-AND-KEEP WOULD REQUIRE A MASSIVE RATE INCREASE TO END USERS

Intercarrier compensation charges today are used to recover the massive investment that both ILECs and CLECs have made in their networks, including investment to deploy broadband facilities to an ever-expanding number of customers. As both the Verizon and AT&T plans for intercarrier compensation reform recognize, any reduction in intercarrier compensation revenue must be recovered elsewhere, and that "elsewhere" is from end users in the form of increased SLCs and USF charges (*i.e.* the so-called RM). What Qwest ignores is that adopting a universal bill-and-keep system -- and effectively setting an access charge and reciprocal compensation rate of zero -- would result in massive rate shock to enormous numbers of consumers of telecommunications services.

While we do not have access to AT&T's cost model -- and note that AT&T has every incentive to understate the impact of such shifts in cost recovery responsibility -- we

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10 In the Matter of Implementation of the Local Competition Provisions n the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd 15499. ¶112 (Rel. Aug. 8, 1996).

11 Id.

12 Id.

observe that they recently estimated that setting a unified terminating rate of zero would require a total access recovery shift from carriers to end users of $4.3 billion.[13] Coupled with the AT&T/Verizon proposal to switch to a telephone number based system of USF assessment, this massive shift in cost recovery would result in an unprecedented rate shock to end users, particularly low and moderate volume users of telecommunications services. We note that there is no requirement that interexchange carriers be required to pass-through the windfall realized from receiving free call termination services, and it is unrealistic to think that they will do so.

Such an enormous spike in end user charges simply is unnecessary to solve the arbitrage problems with which the Commission is concerned. There has been no showing that arbitrage would present a significant problem if current reciprocal compensation rates were used as a basis to establish a unified terminating intercarrier compensation rate. Yet use of existing reciprocal compensation rates instead of bill-and-keep would greatly reduce the adverse impact on end users. While we are unable to calculate the specific revenue recovery shift to end users, it appears that use of average current reciprocal compensation rates (rather than bill-and-keep) would reduce the adverse impact of intercarrier compensation reform to end users by more than 75 percent, while still solving any existing significant access arbitrage problems.

IV. MANDATORY BILL-AND-KEEP WOULD SEND INAPPROPRIATE MARKET SIGNALS THAT WOULD RESULT IN SIGNIFICANT MARKET DISTORTIONS

Qwest is incorrect that mandatory bill-and-keep is "the only solution that is a comprehensive fix of all of the broad variety of arbitrage problems"[14] of the current intercarrier compensation system. In reality, a mandatory bill-and-keep regime would send inappropriate economic signals that would result in market distortions not unlike those being experienced today. Instead, the Commission should adopt a cost-based terminating compensation rate while continuing to make bill-and-keep available for use by carriers on a voluntary basis. If compensation rates are cost-based, there will be a natural incentive for carriers to enter into bill-and-keep arrangements when traffic is in balance.

Qwest and other bill-and-keep proponents fail to note that longstanding industry pricing practices that govern the majority of interconnection arrangements for voice traffic already provide for a balance regime of "calling party's network pays" ("CPNP"), whereby the calling party's network pays the called party's local network to terminate a call, and "called party

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13 *See*, AT&T Ex Parte filing, "The Path to a Broadband Future -- Unified Terminating Rates," CC Docket No. 01-92 filed Sept. 12, 2008.

14 *Qwest Sept. 24th Ex Parte*, at 8.

pays", through the imposition of subscriber line charges.[15] This balanced regime is based on the Commission's experience in weighing the benefits of the call to the calling and called parties. Qwest and the other advocates now seek to have the Commission adopt a new threshold premise that of a bill-and-keep regime, whereby it is assumed that the benefits of all calls are shared equally by the calling and called parties.[16] Thus, bill-and-keep proponents argue that calling and called parties should each bear their own costs – a result that assigns the costs of origination to the calling party and the costs of termination to the call recipient.[17] However, while supporters of bill-and-keep characterize CPNP regimes as based on "outdated and faulty assumptions that only calling party end users benefit from a given call,"[18] they do not offer any support for the proposition that calling and called parties benefit equally (and are equally willing to share the costs). Without such evidence, the Commission can only proceed on blind-faith, a completely unacceptable justification for action that will substantially affect so many consumers and telecommunications providers.

Bill-and-keep proponents attempt to back into the conclusion that calling and called parties benefit equally by pointing out that there are various mechanisms that permit consumers to avoid incoming calls.[19] Proponents argue that by actively choosing not to receive some incoming calls (through blocking, screening, or simply not answering), end users demonstrate that calls not avoided must be beneficial. Such conjecture – without substantive support – is not a legitimate basis for overturning longstanding pricing relationships based upon CPNP. Indeed, in reality, it is simply not possible to quantify the benefits received by calling and called parties with enough precision to provide a reasoned basis for intercarrier compensation relationships.[20] At the same time, the following facts are indisputable: (1) the calling party affirmatively selects the person to be called and the time at which the call is placed; (2) the calling party knows who is being called, the nature and purpose of the call, and how much

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15 In the case of a local call, the calling party's LEC is required to pay transport and termination for traffic that terminates on the called party's network. In the case of a long-distance call, the calling party's interexchange carrier pays terminating access charges, either interstate or intrastate, to the called party's LEC to terminate the call and originating access charges to the calling party's LEC to originate the call.

16 *See, e.g., DeGraba Paper* at ¶ 4; *Qwest Sept. 24th Ex Parte*, at 9.

17 It bears noting that even under a CPNP system calls are not cost-free to called parties. The called party incurs costs associated with receiving calls by maintaining an access line and choosing to permit that access line to be occupied for the duration of a particular call.

18 *Qwest Sept. 24th Ex Parte*, at 9.

19 *See, e.g., Intercarrier FNPRM*, at ¶ 31.

20 For example, a call that might be considered beneficial to the called party at 1:00 p.m. might not be considered beneficial if received at 1:00 a.m. and certain calls (*e.g.*, calls from telemarketers or fundraisers) may never be considered beneficial to the called party.

the call will cost; (3) not every call attempt is answered by the called party;[21] and (4) end users can voluntarily agree to pay for incoming calls through subscription to 800-type services. These facts illustrate why it is entirely reasonable to continue to require that the calling party bear the costs of completing a call.[22]

Bill-and-keep proponents are quick to point to "the arbitrage problems that plague the current regime,"[23] blaming those problems on the "vastly disparate rates applicable to services that are functionally identical."[24] Yet advocates of bill-and-keep fail to acknowledge that the regulatory arbitrage they criticize as an unacceptable byproduct of the current intercarrier compensation system would persist in different form under a bill-and-keep regime, particularly the type of regime advocated by Qwest where originating charges are omitted from the plan. Arbitrage opportunities occur when carriers are able to "revise or rearrange transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation, would be viewed as costly or inefficient."[25] Arbitrage opportunities exist under the current CPNP system in part because carriers have the ability to shift costs to competitors (*i.e.*, originating carriers) by seeking customers with high *inbound* calling patterns. Under a bill-and-keep system, however, regulatory arbitrage would persist, except in the opposite direction. Carriers would seek out customers with high *outbound* calling requirements, offering them prices that reflect the fact that they would not be required to pay to terminate those outbound calls. As noted by Verizon in response to the *FNPRM*, "the default bill-and-keep rule proposed by some would encourage a whole new set of arbitrage opportunities."[26]

This arbitrage potential is heightened by the consolidation among the largest incumbent local exchange carriers ("ILECs") – the Regional Bell Operating Companies (RBOCs") – that has occurred over the past several years. As the RBOCs' incumbent operating

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21 In a busy or no answer situation, the called party receives zero benefit but the calling party receives the positive benefit of knowing the called party is not available.

22 Moreover, as Verizon has pointed out, if the Commission mandates a bill-and-keep regime, "[it] will therefore be required to defend … the plainly erroneous premise that interconnection always provides roughly equivalent benefits to the interconnecting carriers – under the same standards that would apply were it to choose any positive rate." Comments of Verizon in Response to FNPRM, CC Docket No. 01-92 (filed May 23, 2005) ("*Verizon Comments*"), at 23 (footnote omitted).

23 *Qwest Sept. 24th Ex Parte*, at 2.

24 *Id.*, at 5.

25 *Intercarrier FNPRM, Appendix C: A Bill-and-Keep Approach to Intercarrier Compensation Reform, An Analysis of Pleadings in CC Docket No. 01-92 by the Staff of the Wireline Competition Bureau* ("*Staff Report*"), at 102.

26 *Verizon Comments*, at 4.

territories expand, a growing percentage of calls are completed entirely within the RBOC's network. Thus, the overwhelming number of local calls and a very sizable percentage of long distance calls no longer involve any intercarrier payments. Yet the RBOCs have not adjusted their retail pricing to reflect the fact that they are no longer being required to make intercarrier compensation payments to terminate calls. At the same time, very few, if any, of the calls handled by a small competitive local exchange carrier ("CLEC") or interexchange carrier ("IXC") are originated, transported, and terminated entirely on that carrier's own facilities. Since smaller carriers would not be able to raise their rates to end users to recover foregone intercarrier compensation revenue should the Commission mandate a bill-and-keep regime, smaller carriers would be placed at a significant competitive disadvantage relative to the RBOCs under mandatory bill-and-keep. Thus, competitive neutrality considerations dictate that smaller carriers continue to be afforded the opportunity to obtain compensation for the termination of calls originated on other carriers' networks through intercarrier compensation arrangements.

Competitive neutrality concerns also arise due to the fact that mandatory bill-and-keep arrangements are not designed to accommodate non facilities-based carriers. The underlying presumption of bill-and-keep is that market equilibrium will result from the exchange of traffic by fully-functional facilities-based networks. In reality, however, not all carriers have facilities-based networks. The market contains various specialized non facilities-based service providers. As explained by BellSouth in comments in response to the *FNPRM*, mandatory bill-and-keep is not competitively neutral because it fails to provide a facilities-based carrier with the ability to capture any portion of the value its network creates for a non facilities-based provider:

> [A]ssume there are three carriers: Carrier A, an interexchange carrier, Carrier B, a full service (local and interexchange) carrier and Carrier C, a local carrier. Assume that a call between end users served by Carrier B and Carrier C is an interexchange call. If Carrier A and Carrier B compete in the interexchange market segment, under a bill-and-keep arrangement, both carriers would have to bear the cost of interexchange transport, but only Carrier B has to bear the cost of the local network where the call originates. The result is not competitively neutral.[27]

In addition, mandatory bill-and-keep provides disincentives for network investment:

> Furthermore, such a result would distort economic entry by denying the local carrier, Carrier C, the opportunity to recover the cost of enabling the interexchange call. Consequently, because

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27 Comments of BellSouth Corporation, CC Docket No. 01-92 (filed May 23, 2005) ("*BellSouth Comments*"), at 10.

> Carrier C will not be able to capture even a portion of the value its network creates for Carrier B and its customers, Carrier C's investment in its network will be inefficiently distorted.

In short, a mandatory bill-and-keep system would provide disincentives for investment in networks and network improvements, as network owners would be unable to recoup the value created by those investments. At the same time, other providers would have strong incentives to free ride on the investments of facilities-based service providers. The disincentive to network investment created by mandatory bill-and-keep is directly at odds with the Commission's longstanding and oft-stated policy goal to promote network facilities deployment and facilities-based competition.[28]

Finally, the lack of competitive neutrality in the bill and keep regime proposed by Qwest is further evidenced by its declaration that the regime must include several additional policies: new local interconnection requirements, a new access recovery mechanism to make incumbent local exchange carriers whole, and the ability for incumbent to impose selectively subscriber line charges. Each of these proposals is blatantly biased in favor of incumbent carriers and will inhibit competition. In addition, each is legally suspect. They provide additional justification that a bill and keep regime may have superficial appeal at first glance but lacks real benefits when subjected to close scrutiny.

V. **CONCLUSION**

A regime that limits compensation to forward-looking economic costs is the only real means to eliminate arbitrage and to ensure continued network investment. The Commission should reject Qwest's call for mandatory bill-and-keep and should instead expeditiously adopt a cost-based rate for termination of all traffic within the federal jurisdiction.

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[28] Furthermore, under mandatory bill-and-keep, the terminating carrier has less incentive to provide good service since it is not getting paid for the termination service it provides.

Sincerely,

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